



Hong Kong Regulatory Update

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This update provides an overview of key regulatory developments in the third quarter relevant to companies listed, or planning to list, on The Stock Exchange of Hong Kong Limited (**HKEx**) and their advisers. It covers amendments to the Rules Governing the Listing of Securities on HKEx (**Listing Rules**) as well as announcements, guidance and enforcement-related news from HKEx and the Securities and Futures Commission (**SFC**). Other recent market developments may also be included. We do not intend to cover all updates that may be relevant, but we welcome feedback, so please contact us if you would like to see analysis of other topics in the future.

HKEx To Launch FINI and T+2 IPO Settlement

Following the completion of several rounds of user testing, market practice sessions and rehearsals by Hong Kong's IPO market participants, HKEx confirmed that the FINI (Fast Interface for New Issuance) platform will launch on 22 November 2023.

FINI's launch is a milestone development for Hong Kong's capital markets, offering a streamlined and digitalised IPO settlement process. The time between the pricing of an IPO and settlement and the commencement of trading of shares will be significantly shortened from five business days (T+5) to two (T+2), hence reducing market risk for all market participants. FINI also includes a new IPO funding mechanism to reduce the scale of locked-up funds in over-subscribed IPOs.

FINI operates on a cloud-based platform that will enable various stakeholders, including IPO sponsors, underwriters, legal counsel, banks, clearing participants, share registrars and regulators, to collaborate simultaneously and gain instant access to information, increasing efficiency and reducing paperwork.

HKEx Proposes To Permit Treasury Shares

Historically, HKEx has not permitted treasury shares, and required listed companies to cancel any repurchased shares. However, in a new market consultation, HKEx has announced plans to permit listed companies to hold their own shares as treasury shares, and to introduce rules governing the resale of treasury shares.

Resales of treasury shares will be governed by the same rules applicable to the issuance and sales of new shares. As such:

- Resales of treasury shares must be either offered to all shareholders on a pro rata basis or conducted under a shareholders' mandate, which may be either a general or specific mandate. Most listed companies in Hong Kong obtain a general mandate from shareholders to issue new shares representing up to 20% of their issued share capital in any 12-month period. In addition, this general mandate is increased by the number of shares repurchased in a year (up to the 10% share repurchase mandate limit). Resales of treasury shares will count against these mandate limits.

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- Resales of treasury shares will be subject to a maximum price discount of 20%, similar to placings of new shares under a general mandate.

Companies listing on HKEx for the first time will be permitted to retain any existing treasury shares, but will not be permitted to conduct any resales until six months after listing.

To guard against market manipulation, the following limitations will apply:

- The existing moratorium on issuance of new shares within 30 days after any share repurchase will also apply to resales of treasury shares, such that companies may not resell any treasury shares within 30 days after any share repurchase.
- Companies also may not undertake an on-market share repurchase within 30 days after any resale of treasury shares.
- The existing restriction on undertaking share repurchases while there is undisclosed inside information or during the one-month period preceding any results announcement shall also apply to resales of treasury shares.
- Companies may not knowingly sell treasury shares on-market to a core connected person, while sales of treasury shares off-market to connected persons will be subject to the usual connected transaction rules. On-market sales of treasury shares to a connected person without knowledge will be fully exempt from the connected transaction rules.

Companies which have received existing waivers from the share cancellation requirement, permitting them to hold treasury shares, will be required to comply with the new Listing Rule requirements after the rule amendments become effective. However, HKEx has indicated that it will consider waivers from the new rule requirements on a case-by-case basis.

The proposals are subject to market consultation, with the consultation period ending on 27 December 2023.

HKEx Issues Guidance on Share Buyback Programs

In a [new guidance letter](#), HKEx has set out a framework under which it will grant waivers for listed companies wishing to implement automatic share buyback programs. These programs are commonly implemented in other markets (such as the U.S., where they are sometimes known as “10b5-1 repurchase programs”), and HKEx has historically granted waivers on an *ad hoc* basis for dual-listed companies. Such waivers have permitted companies to undertake repurchases pursuant to such programs during the “blackout periods” for share repurchases under Hong Kong rules, which apply during the one-month period prior to the release of financial results or when the company is in possession of undisclosed inside information.

Under the new guidance letter, HKEx will consider granting waivers for automatic share buyback programs to any listed company (regardless of whether they are dual listed), subject to compliance with a number of safeguard measures, including:

- The program must be established outside any applicable blackout periods, and must not be modified or terminated during a blackout period.
- The company must appoint one single independent broker to operate the program.
- The program must operate under an irrevocable nondiscretionary arrangement with that broker, with fixed trading parameters for price, volume and dates, or formulae for the same.
- There must be systems and controls in place to ensure there is no influence by the company over the program and no nonpublic information of the company is given to any personnel of the broker involved with the program.

To avoid an adverse impact on share price and market manipulation, HKEx will consider granting waivers only to companies with large market capitalization (HK\$10 billion or above) and sufficient liquidity in their securities (average daily turnover volume of at least HK\$10 million).

Note that the waivers will apply only to programs for a company’s repurchase of their own shares, and will not extend to programs for the sales of shares by insiders (another common feature in international markets).

HKEx Publishes Guidance on Directors’ Duty To Avoid Conflict of Interest

HKEx has emphasized directors’ duties to avoid conflicts of interest in [its most recent enforcement bulletin](#) (September 2023).

The duty to avoid conflict of interest is part of a director’s fiduciary duty of loyalty owed to the company, with its scope not only limited to actual conflicts, but also covering indirect or potential conflicts. The definition of “conflict” has a low threshold, so situations where there is a risk of conflict that seems indirect, low or remote may also constitute “conflict” for this purpose. Instead of deciding the outcome alone, directors should always declare and discuss the situation or relationship concerned with the rest of the board members to effectively and promptly manage possible conflicts. In particular, when there are business opportunities and relationships arising from contacts known personally to directors or shareholders, it is crucial to assess whether these constitute connected transactions under the Listing Rules.

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HKEx will discipline issuers and directors who fail to establish, implement and follow internal controls that deal appropriately with potential conflicts of interest and duty. Therefore, setting up and adhering to effective conflict management processes is important for listed issuers. Examples of effective processes include: keeping written and up-to-date records of all interests held in other corporations and declarations for inspection by directors; providing regular training; and having different people carrying out different roles to ensure segregation of power.

SFC Concludes Consultation on Amendments to SFO To Strengthen Enforcement

The SFC has published its conclusions on a June 2022 market consultation on enforcement-related amendments to the Securities and Futures Ordinance (**SFO**). Please see our [August 2022 update](#) for further details of the consultation.

In the consultation conclusion, published in August 2023, the SFC confirmed it will proceed with its proposal to broaden the scope of the SFO's insider dealing provisions. The scope will be broadened to cover:

- Insider dealing perpetrated in Hong Kong with respect to securities listed on overseas stock markets or their derivatives.
- Insider dealing perpetrated outside of Hong Kong if it involves any securities listed on the HKEx.

The industry will have the opportunity to review the draft amendments during the legislative process.

However, considering the complex implementation issues raised by the respondents to the consultation, the SFC concluded that it will put the following two proposed amendments on hold:

- Expanding the bases on which the SFC can take action against regulated persons under SFO Section 213.
- Clarifying the authorized scope for investment product advertisements.

The SFC will continue to monitor market developments and consider a full range of options to ensure investors are adequately protected.

SFC Issues Conclusions on Amendments to the Takeover Code

SFC recently issued the conclusions on its market consultation related to the proposed amendments to the existing Codes on Takeovers and Mergers and Share Buy-Backs (covered in our [August 2023 update](#)). The conclusions adopted all of the proposals, subject to minor modifications. The amendments became effective on 29 September 2023.

SFC and AFRC Publish Joint Statement on Dubious Fund Transfers by Listed Issuers

The SFC and the Accounting and Financial Reporting Council (**AFRC**) have issued their first [joint statement](#), addressing an uptick in instances of misconduct involving listed issuers channeling their funds to third parties in dubious circumstances, often veiled as loans, advances, prepayments, deposits or other similar arrangements.

Their observations, some of which were covered in our [January 2023 update](#), highlight key issues with these dubious loans, including:

- **Lack of commercial rationale** — *e.g.*, interest at a rate far below the cost of funds, grant of loans on an unsecured and interest-free basis, and prepayment for purchase of goods without any advance payment requirement and delivery of goods.
- **Insufficient risk assessments, due diligence or documentation** — *e.g.*, lack of credit assessments or background checks on the borrowers, and grant of loans without any collateral on the basis that the borrowers had assets but no due diligence was conducted as to whether they are free from encumbrances.
- **Inadequate internal control systems** and policies for granting, monitoring and recovering the loans — *e.g.*, unclear approving body, lack of prompt recovery actions in case of default, and lack of legitimate commercial reasons and proper approval for extension of repayments.

The joint statement outlines the standards of conduct expected of directors and audit committees of listed issuers concerning loans and similar arrangements:

- **Directors** should ensure that material loans are subjected to effective vetting, risk assessments and due diligence processes and proper approval, and that the issuer's public disclosures give a true and fair view. They should oversee the risk management and internal control systems on an ongoing basis and ensure that their effectiveness is reviewed at least annually. Directors should ensure that a credit assessment conducted by competent personnel is undertaken, and appropriate collateral secured. Due diligence should be conducted on the background, financial strength and repayment capability of the borrowers and sufficiency of the collateral or guarantees provided, and they should be properly documented.
- **Audit committees** should ensure that the issuer has appropriate internal controls for granting loans, monitoring their repayment and determining impairment, and that the loans are appropriately accounted for and disclosed in the financial statements. The committee should ensure that the company has set procedures for loans above a threshold amount to have prior approval by the board and for the appropriateness of the threshold to be regularly reviewed by the committee

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and the board. Furthermore, they should maintain dialogues with auditors to address significant matters concerning the loans identified from the audit.

Enforcement Matters

HKEx Censures Optima Automobile and Its Directors for Issuing Misleading Listing Prospectus

In a relatively rare action targeting misleading prospectus disclosure, HKEx has censured and criticized Optima Automobile Group Holdings Limited and its executive directors.

HKEx found that:

- In the two months leading up to Optima Automobile's listing, there was a significant deterioration in its financial performance. However, such facts were not disclosed in the prospectus issued in September 2019, which only set out the company's financial performance through 31 July 2019 and contained the directors' confirmation that there had been "no material adverse change" to the company's financial position from 31 March 2019 up to the date of the prospectus.
- Optima Automobile's actual listing expenses increased by 80% from those forecast in the prospectus, primarily attributable to an underwriter's bonus and a listing consultant's fee. The underwriter's bonus was proposed for the professional services rendered but the underwriter did not provide an itemized breakdown of the work or hours expended. Similarly, the invoice of the consultant did not contain details of the work conducted or rates charged by him, and such fee was only requested after the listing. Despite the significant increase and the fact that these undisclosed expenses amounted to nearly 19% of the total listing proceeds, the directors agreed to pay the amounts.

This matter reminds issuers that (i) the prospectus must contain accurate and complete disclosure, to enable investors to make an informed assessment of the activities, profits and losses, assets and liabilities, financial position, management, and prospects of the issuer; (ii) directors should ensure that there is a reasonable basis for making a statement of "no material adverse change" in the prospectus; and (iii) directors have a duty to safeguard the assets of issuers, which include proceeds of the initial public offering, and ensure the proper use of the issuer's assets and there being a sound basis for any payments made.

Market Misconduct Tribunal Fines Mayer for Late Disclosure of Inside Information

The Market Misconduct Tribunal (MMT) has delivered a finding against Mayer Holdings Limited and its directors for failure to disclose inside information "as soon as reasonably practicable" as required under the SFO. The ruling followed a re-hearing of a case originally determined in 2017, but subsequently successfully appealed to the Court of Appeal and sent for reconsideration by the MMT.

The undisclosed information included:

- The resignation of Mayer's auditors.
- The questionable character of the disposal of a wholly owned subsidiary of Mayer.
- The commercial substance and/or recoverability of two substantial prepayments made to suppliers by Mayer's jointly controlled entities without security.

In its ruling, the MMT assessed the cumulative impact the undisclosed information would have had on potential buyers and sellers of shares at the material time. The MMT was satisfied that the undisclosed information constituted inside information, as it would have been likely to have had a material effect on the share price of Mayer.

The MMT found that Mayer's lack of written guidelines and internal control policies on the disclosure of inside information contributed to its breach of the disclosure obligations imposed on it under the SFO. This case reminds companies of the importance of having such guidelines and policies, and ensuring the timely disclosure of inside information.

Recent HKEx Disciplinary Actions Target Directors' Duties

In a number of recent disciplinary actions, HKEx has targeted listed company directors for their failure to act with appropriate diligence, safeguard the interests and assets of the company, avoid conflicts of interest and ensure effective internal controls.

In the first case, Ourgame International Holdings Limited granted loans of over HK\$62 million to a borrower introduced by one of its substantial shareholders, of which a former nonexecutive director was a substantial shareholder. The former chairman approved the loans on the understanding that the loans were guaranteed by Ourgame's substantial shareholder. However, he failed to conduct proper due diligence on the borrower and did not exercise due care and diligence in respect of the execution, management and oversight of the loans. He did not follow up on whether any guarantee was provided. The borrower later defaulted on the loans.

The substantial shareholder then arranged for a third party to take over the obligations to repay, which was in turn personally guaranteed by the former nonexecutive director. However, it later turned out that the former nonexecutive director attempted to waive the obligations of the third party to repay the loans without any apparent commercial rationale, to the detriment of Ourgame. Ourgame conducted investigations and took the view that the former nonexecutive director had misappropriated the company's assets through the above arrangements.

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As such, HKEx found both the former chairman and non-executive director to be in breach of their directors' duties for failure to safeguard Ourgame's assets and to exercise proper care and diligence in arranging and handling the loans. HKEx censured and imposed a director unsuitability statement against the former non-executive director, ruling that she is unsuitable to occupy a position as director or within senior management of Ourgame or any of its subsidiaries. HKEx also criticized the former chairman and further directed him to attend 15 hours of training.

In the second case, involving Hope Life International Holdings Limited, a joint venture business opportunity was proposed to the former chairman and executive director of Hope Life, whereby a subsidiary of the company would purchase electronic products from certain suppliers for onward selling to certain buyers with a small margin. Both suppliers and buyers were designated by the former chairman, who guaranteed the buyers' payment obligations. Despite the business being new to Hope Life, the former chairman conducted only limited due diligence and failed to conduct any commercial or risk assessment in respect of the new business. Without informing or obtaining approval from the board of directors, the former chairman proceeded with the new joint venture business which turned out to be a vehicle through which she misappropriated all monies paid by Hope Life in respect of such joint venture. It appeared that no electronic products were ever delivered.

As such, HKEx found the former chairman to be in breach of her duties under the Listing Rules for failure to (1) safeguard the assets of Hope Life, (2) exercise proper care and diligence when entering into the new joint venture business and assess the relevant risks thereof, and (3) inform or have the new joint venture business approved by the board of directors of Hope Life. A director unsuitability statement was imposed against her that she is unsuitable to occupy a position as director or within senior management of Hope Life or any of its subsidiaries.

Finally, in a case involving China Saite Group Company Limited, the former chairman used his position as director to cause the company to provide him a series of loans and advances amounting to RMB150 million from 2014 to 2019. The former chairman did not disclose these transactions to the board, and they were not announced despite them constituting connected transactions under Chapter 14A of the Listing Rules. In March 2020, the company's auditor discovered the loans and also other transactions that were not recorded in the company's accounting records. The auditor raised its concerns as material audit issues. However, at the chairman's direction, the company withheld information about these audit issues and concerns from HKEx and the investing public. In addition, no prompt announcements were made in respect of some 14 winding-up petitions presented against China Saite between April and July 2019.

HKEx criticized the former chairman for being the decision-maker of the company's failures. Despite his questionable conduct and evident conflict of interest, and the significance of the issues, the other directors did not raise enquiries or take follow-up actions to procure the company's Listing Rule compliance, even when the events were brought to their attention. The other directors on the board were all aware of the concerns leading to the audit issues, and that information about them was being withheld, but did not object to or even question the former chairman's decision to withhold disclosure. The independent non-executive directors in particular failed to apply their independent judgment.

Furthermore, all of the directors failed to discharge their duties to ensure the company had adequate and effective internal controls. There were material deficiencies in fundamental areas, such as controls relating to connected transactions, contract approval and payment authorisation. The failures of the directors with specific responsibilities for internal controls, including the compliance committee members and/or independent non-executive directors, were particularly serious.

HKEx imposed various disciplinary actions against 10 directors for prejudicing the company's interest. Prejudice of investors' interests statements were imposed against five directors, which indicates HKEx's opinion that the retention of office by these directors is or would have been prejudicial to the interest of investors.

These cases serve to remind directors of listed companies that they must observe their duty to act with due care, skill and diligence and safeguard the interests and assets of the listed issuers. Directors must assess the risks and benefits of proposed transactions especially when entering into a new business, and conduct appropriate due diligence prior to entering into transactions. Directors must also avoid conflicts of interest, and not treat the company's assets as their own or place their own interest above that of the company. Independent non-executive directors are also reminded that, although they are not involved in day-to-day operations and management of a company, HKEx regards them as having a key role to play in Listing Rule compliance and corporate governance.

HKEx Criticizes E&P Global for Breach of Notifiable Transactions Requirements

Listed companies conducting acquisitions and/or disposals of their assets should be aware that these transactions may be notifiable and subject to disclosure requirements under Chapter 14 of the Listing Rules. These requirements apply equally to a listed company's subsidiaries, as illustrated by a recent HKEx disciplinary action against E&P Global Holdings Limited.

Between August 2021 and January 2022, E&P Global's Korean subsidiary entered into a series of transactions involving the

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acquisition, conversion and subsequent disposal of convertible bonds, each constituting either a major transaction or a very substantial disposal. However, the company failed to comply with the corresponding announcement, circular and shareholders' approval requirements under the Listing Rules. HKEx criticized E&P Global for its failure to comply with the relevant requirements.

Listed companies are reminded to implement adequate internal communication, monitoring and control, so as to ensure timely disclosures of their subsidiaries' transactions.

HKEx Censures Lisi Group for Failure To Comply With Chapter 14 and 14A of the Listing Rules

Repeated failures to comply with Listing Rule requirements are often indicative of a lack of appropriate internal controls and systems.

This was demonstrated by a recent disciplinary case involving Lisi Group (Holdings) Limited. Between 2017 and 2020, Lisi Group entered into various discloseable, major and continuing connected transactions without making timely disclosure or obtaining the necessary approvals from its shareholders as required under Chapters 14 and 14A of the Listing Rules. Those transactions included provision of services to its subsidiary, mutual supply of products to/from its indirect wholly owned subsidiary, subscription for financial products and the provision of guarantees by its subsidiary to customers. Despite previous, similar instances of noncompliance, and being formally warned by HKEx, Lisi Group continued to fail to maintain adequate and effective internal controls and repeatedly failed to comply with the Listing Rule requirements.

HKEx directed Lisi Group to (a) appoint a compliance adviser for two years, (b) conduct an independent review of its internal controls in relation to compliance with Chapters 13, 14 and 14A, and (c) procure each of the current directors to attend 24 hours of training.

HKEx reminds listed companies that they must apply an effective assessment and control framework to the transactions they enter into, as this will help issuers to ensure that they comply with Listing Rule obligations. If an issuer is aware of previous Listing Rule compliance failings, it must take prompt steps to address any weaknesses in its processes to ensure that similar breaches do not happen again.

SFC Sanctions Changjiang Corporate Finance for Sponsor Failures

The SFC has fined Changjiang Corporate Finance (HK) Limited HK\$20 million and suspended its license for serious and extensive failures in discharging its duties as the sponsor in six listing applications between 2015 and 2017.

The companies involved and related failures were as follows:

Pacific Infinity Resources Holdings Limited	Failed to perform any due diligence on a Philippine legislative bill and white paper which, if enacted, had the potential to significantly affect Pacific Infinity's business.
AsiaPac Net Media Holdings Limited	Failed to advise AsiaPac on making sufficient disclosure to enable the HKEx and investors to understand the type and nature of its sources of procurement costs and supplier contracts, which had a material impact on the company's profitability.
Perpetual Power Holdings Limited	Failed to advise the company against submitting its listing application despite it not being eligible for listing due to outstanding land title and building ownership certificates.
Van Chuam International (Cayman) Limited	Failed to ensure that the company's application proof prospectus adequately disclosed all material information pertaining to debt restructuring arrangements made with an asset management company.
Rising Sun Construction Holdings Limited	Failed to exercise professional skepticism by accepting at face value without performing appropriate verification the statements and representations made by the company regarding its cash flows, trade receivables and ability to meet working capital requirements.
Byleasing Holdings Limited	Failed to properly advise the company on its track record period and appropriate timing of submission of its listing application in accordance with the related HKEx guidance, resulting in the listing application being returned.

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The SFC found that Changjiang Corporate Finance had failed to:

- Perform all reasonable due diligence in the listing applications, in turn failing to assess the entities' suitability for listing.
- Properly advise and guide the companies on complying with all relevant listing qualifications.
- Ensure disclosure of all material information in the application prospectuses.
- Maintain proper records of the due diligence work it claimed to have conducted.